Federal Trade Commission

VERTICAL RESTRAINTS: A PERSPECTIVE FROM THE FEDERAL TRADE COMMISSION

REMARKS OF
MARY L. AZCUENAGA
COMMISSIONER

FEDERAL TRADE COMMISSION

before

AMERICAN BAR ASSOCIATION
ANTITRUST SECTION
NEW YORK, NEW YORK

August 10, 1993

The views expressed are those of the Commissioner and do not necessarily reflect those of the Federal Trade Commission or any other commissioner.

Good morning. I appreciate the opportunity to participate on this panel on vertical restraints. I plan to talk this morning about the activity of the Federal Trade Commission in the area of vertical restraints and to offer a few observations of my own. As is customary, my remarks are my own and do not necessarily reflect the views of the Commission or of any other commissioner.

The Commission's vertical restraints enforcement program was perhaps most visible in the 1970's, after the demise of state fair trade laws, which protected resale price maintenance from federal law, and before GTE Sylvania,[1] in which the Supreme Court held that non-price vertical restraints should be analyzed under the rule of reason. Some have called the shift in emphasis from vertical restraints enforcement the "Reagan Revolution," but as Richard Steuer has pointed out, a "shift in [antitrust] philosophy first appeared in the mid-1970's," not at the federal enforcement agencies, but "in some pivotal decisions of the United States Supreme Court and the lower federal courts."[2] In the vertical restraints area, GTE Sylvania in 1977 was one of those pivotal decisions. Seven years later, in Monsanto,[3] the Court reaffirmed the protections afforded by Colgate and Sylvania and made more clear the sphere of lawful distribution practices by limiting the circumstances in which a vertical agreement on price may be inferred.

I think it is safe to say that the Commission did not anticipate these developments in the law. The Commission in its 1982 decision in Beltone Electronics applied the rule of reason, as required by Sylvania, but the complaint in Beltone was issued in 1973, when Schwinn[4] was the law and non-price vertical restraints generally were viewed as unlawful. Schwinn still was the law when the initial decision issued, finding Beltone liable, and when Beltone appealed to the Commission. After oral argument but before the Commission issued its decision, the Supreme Court decided Sylvania, expressly overruling Schwinn. After a remand for additional fact-finding in light of Sylvania, the Commission found no violation and dismissed the Beltone complaint.

---

[1] Continental T.V., Inc. v. GTE Sylvania, Inc., 433 U.S. 36 (1977).

[2] R. Steuer, "The Turning Points in Distribution Law," 35 Antitrust Bull. 467, 467-68 (1990).

[3] Monsanto Co. v. Spray-Rite Service Corp., 465 U.S. 752 (1984).

[4] United States v. Arnold, Schwinn & Co., 388 U.S. 365, 379 (1967) (Unreasonable "for a manufacturer to seek to restrict and confine areas or persons with whom an article may be traded after the manufacturer has departed with dominion over it.").

After Sylvania, the Commission's nonprice vertical restraints program clearly would need rethinking, but enforcement against resale price maintenance continued. The Commission's enforcement against resale price maintenance achieved perhaps its high water mark (or low water mark, depending on your perspective) in Russell Stover.[5] The complaint in Stover, issued in 1980 as a direct challenge to the Colgate doctrine,[6] was based on the not implausible theory that "an agreement is created when there is unwilling compliance resulting from a threat of termination."[7] Stover maintained a policy of refusing to deal with retailers that it believed would sell at less than suggested prices, and it terminated retailers that sold at less than suggested prices.[8] Coercion is coercion, the Commission said, and there simply is no difference, for purposes of inferring an agreement on price, whether a dealer's unwilling compliance is coerced by a threat of termination or by an announced policy of terminating discounters.[9]

It is easy to be critical of Russell Stover from this distance, after the decision of the Supreme Court in Monsanto, and some were critical of the case when it was brought. At the time, however, the scope of the protection afforded a seller under Colgate was far from clear. Dealer acquiescence or unwilling compliance under coercion was thought to be a basis for inferring agreement.[10] Professor Areeda said before Monsanto was decided that "[t]he Colgate rule has been so widely eroded that most lower courts . . . hold that a manufacturer reinforcing any

---

[5] Russell Stover Candies, Inc., 100 F.T.C. 1, 34 (1980) (Chairman Miller dissenting), rev'd, 718 F.2d 256 (8th Cir. 1983).

[6] See Speech by B.S. Sharp, Assistant Director for Regional Operations, FTC Bureau of Competition, "Vertical Restraints and the FTC: Finding Pro-Competitive Answers to Today's Enigmas," ALI-ABA Course of Study, "The FTC After the Storm" (Washington, D.C. Nov. 21, 1980), cited in 100 F.T.C. at 7.

[7] 100 F.T.C. at 40.

[8] 100 F.T.C. at 17-18.

[9] 100 F.T.C. at 35.

[10] See Albrecht v. Herald Co., 390 U.S. 145, 150 n.6 (1968) ("Under Parke, Davis, petitioner could have claimed a combination between respondent and himself, at least as of the day he unwillingly complied with respondent's advertised price. Likewise, he might successfully have claimed that respondent had combined with other carriers because the firmly enforced price policy applied to all carriers, most of whom acquiesced in it.").

kind of restricted distribution policy by terminating recalcitrant dealers has 'conspired' with somebody."[11]

The Court of Appeals for the Eighth Circuit reversed the Commission's decision in Stover. "If Colgate no longer stands for the proposition that a 'simple refusal to sell to customers who will not sell at prices suggested by the seller is permissible under the Sherman Act,'" the court said, "it is for the Supreme Court . . . to so declare."[12] One criticism by the court of appeals of the Stover case is reminiscent of the emphasis by the Supreme Court this last term on the "realities of the marketplace" in antitrust cases.[13] The court of appeals, quoting the administrative law judge, described the Commission's case as a "'stipulated lawyer's construct . . . lovingly nurtured like a hothouse flower . . . [having] little to do with the real world.'"[14]

In retrospect, the Commission also appears to have been swimming against the tide when, in 1980, the same year that it issued the complaint in Russell Stover, it announced a policy to challenge price restrictions in cooperative advertising programs as per se unlawful.[15] The policy was announced in conjunction with two consent orders barring sellers from conditioning cooperative ad payments on the use of the seller's suggested prices.[16] The Commission reasoned that requiring a dealer, as a condition of receiving cooperative advertising dollars, to advertise at suggested prices or to refrain from discount pricing "tends to deter dealers from engaging in vigorous price competition" and may "have the effect of maintaining resale prices." When the policy was adopted, the Commission recognized

---

[11] P. Areeda, "The State of the Law," Regulation 20 (Jan./Feb. 1984).

[12] 718 F.2d at 260 (citation omitted).

[13] Brooke Group Ltd. v. Brown & Williamson Tobacco Corp., 61 U.S.L.W. 4699 (U.S. June 21, 1993) ("realities of the market"); Eastman Kodak Co. v. Image Technical Services, Inc., 112 S. Ct. 2072 (1992) ("market realities").

[14] 718 F.2d at 260, quoting 100 F.T.C. at 14 (Initial Decision).

[15] Reprinted at 6 Trade Reg. Rep. (CCH) ¶ 39,057.

[16] Tingley Rubber Co., 96 F.T.C. 340 (1980); totes incorporated, 96 F.T.C. 335 (1980).

that at least one court of appeals had applied the rule of reason to analyze price-restrictive cooperative advertising programs.[17]

The Commission rescinded the policy in 1987, recognizing that, after Monsanto, price-restrictive cooperative advertising programs "do not establish the existence of an agreement on price" and "like other vertical restraints that are subject to a rule of reason analysis . . . may provide competitive benefits or . . . may be competitively neutral."[18] Of course, this leaves open the possibility that a particular price-restrictive cooperative advertising program may be unreasonable in the circumstances.

A year after the decision of the court of appeals in Stover, the Supreme Court resoundingly reaffirmed the Colgate doctrine and rejected the theory that a seller's policy to terminate discounters could be the basis for inferring an unlawful agreement. In Monsanto, the Court said that "[u]nder Colgate, the manufacturer can announce its resale prices in advance and refuse to deal with those who fail to comply. And a distributor is free to acquiesce in the manufacturer's demand in order to avoid termination."[19]

The issue in Monsanto, whether an unlawful agreement could be inferred from termination of a discounter following price-related complaints from other dealers, brought before the Court the tensions between the different treatment under the law of nonprice vertical restraints and resale price maintenance. Although the Court in Sylvania said that conduct should be "judged primarily by its 'market impact,'"[20] the Court in Monsanto recognized that the economic effect of both price and nonprice vertical restraints "is in many . . . cases similar or identical" and the conduct may be "indistinguishable."[21] When this occurs, the Sylvania "market impact" test would not distinguish between price and nonprice restrictions and the

---

[17] In re Nissan Antitrust Litigation, 577 F.2d 910 (5th Cir. 1978), cert. denied, 439 U.S. 1072 (1979).

[18] Statement of Policy Regarding Price Restrictions in Cooperative Advertising Programs -- Rescission, reprinted in 6 Trade Reg. Rep. (CCH) ¶ 39,057 (May 21, 1987).

[19] 465 U.S. at 761. See also Business Electronics Corp. v. Sharp Electronics Corp., 485 U.S. 717 (1988) (vertical restraint is not per se unlawful without agreement on price or price levels).

[20] 465 U.S at 762.

[21] Id. at 762.

question would arise whether the per se rule for resale price maintenance should be retained.[22]

At the same time, allowing relatively easy inferences of unlawful resale price maintenance agreements from price-related discussions between a seller and its dealers could limit communications identified in Sylvania as legitimate or even procompetitive.[23] In Monsanto, the Court apparently sought to protect both "the market-freeing effect of [its] decision in GTE Sylvania"[24] and the per se rule against resale price maintenance by requiring that an unlawful agreement be proved by evidence "that tends to exclude the possibility that the manufacturer and nonterminated distributors were acting independently."[25] The Court said that termination of a dealer, even "'in response to'" dealer complaints,[26] is only ambiguous evidence of an agreement: "If an inference of [a price-fixing] agreement may be drawn from highly ambiguous evidence, there is a considerable danger that the doctrines enunciated in Sylvania and Colgate will be seriously eroded."[27]

After Sylvania and before Monsanto, the debate about vertical restraints focused on the different legal treatment accorded price and nonprice restraints. Many argued that resale price maintenance and nonprice vertical restraints often were similarly motivated and had similar consequences and, therefore, should be similarly analyzed under the rule of reason.[28] Then-

---

[22] See Concurring Opinion of Justice White in Sylvania, 433 U.S. 59, 69-70 ("It is common ground among the leading advocates of a purely economic approach . . . that the economic arguments in favor of allowing vertical nonprice restraints generally apply to vertical price restraints as well." (Citations omitted.)).

[23] 465 U.S. at 762 ("[I]t is precisely in cases in which the manufacturer attempts to further a particular marketing strategy by means of agreements on often costly nonprice restrictions that it will have the most interest in the distributors' prices.").

[24] Business Electronics Corp. v. Sharp Electronics Corp., 485 U.S. at 726.

[25] Monsanto, 465 U.S. at 764.

[26] Id. at 763.

[27] Id.

[28] See, e.g., T.R. Overstreet, Jr., Resale Price Maintenance: Economic Theories and Empirical Evidence, Bureau of Economics Staff Report to the Federal Trade Commission 10 (Nov. 1983).

professor, now Judge Posner suggested that a policy making all vertical distribution restraints, both price and nonprice, per se legal would "both simplify the law and make it economically more rational."[29] Professor Areeda, with some prescience, suggested shortly before Monsanto was decided that uncertainty in the vertical restraints area could be resolved either by extending the rule of reason to resale price maintenance or by defining more precisely what constitutes an agreement.[30]

The same debate informed the vertical restraints enforcement program at the Commission. The Commission devoted much time and effort in the post-Sylvania era to attempting to structure the rule of reason analysis for nonprice vertical restraints and to develop criteria for case generation.[31] Several suggestions were put forward. Given the significant investment in time and resources necessary for a rule of reason case, perhaps the Commission should push the analysis toward the presumptively unreasonable end of the spectrum. Perhaps the Commission should focus its investigative efforts only on firms with market power, because when interbrand competition is limited by market power, the potential procompetitive effects of vertical restraints were less likely to be realized. Instead of challenging pure nonprice vertical restraints, an effort that might simply replicate Sylvania, perhaps the Commission could identify a case to test the effects of combined price and nonprice restraints. If the effects of the different types of restraints could not be separately quantified,[32] perhaps the entire package might be held

---

[29] R. Posner, "The Next Step in the Antitrust Treatment of Restricted Distribution: Per Se Legality," 48 U. Chi. L. Rev. 6, 25 (1981); see also Easterbrook, "Restricted Dealing Is a Way To Compete," Regulation 23 (Jan./Feb. 1984) ("Neither resale price maintenance nor any other restriction adopted by a manufacturer for its dealers should be a subject of serious antitrust attention."); Sharp, 485 U.S. at 726 ("[T]here is a presumption in favor of a rule-of-reason standard . . . and that rules in this area should be formulated with a view towards protecting the doctrine of GTE Sylvania.").

[30] P. Areeda, "The State of the Law," Regulation 19, 22 (Jan./Feb. 1984).

[31] Bureau of Competition and Regional Offices, Federal Trade Commission, Report of the Vertical Restraints Task Force (Oct. 1978).

[32] See Overstreet, supra note 28, at 12 ("economic theories are . . . not sufficiently developed to fully understand the interactions or effects" of combined price and nonprice restraints).

to the per se standard,[33] although others suggested that the rule of reason should apply.[34]

The internal debate was lively but not very productive, if we measure productivity solely in terms of the number of cases brought. I think it is true that the Commission has not brought a complaint in a nonprice vertical restraints case since Beltone was decided. The absence of vertical nonprice cases from the Commission might support a number of different inferences, but in retrospect, prudent case selection might be the most probable. The courts have not been very hospitable to nonprice vertical cases since Sylvania. In a study published in 1991, Judge Ginsburg examined the treatment by the federal courts of appeal of nonprice vertical restraints after Sylvania and concluded that defendants mostly win, at least in non-monopolistic markets.[35]

In the area of resale price maintenance, before and after Monsanto, discussion at the Commission focused on the elements necessary to prove an unlawful agreement. The difficult parsing of the treatment of discussions of price in the context of legitimate nonprice vertical restraints and the appropriate basis for inferring agreement were part of the evaluation process at the Commission before Monsanto was decided and the limits of Colgate reestablished. After Monsanto and then Sharp, arguably it was more difficult to prove an unlawful agreement, and the number of new resale price maintenance cases at the Commission diminished. Certainly the two opinions of the Supreme Court, coming on the heels of Stover, indicated that some retrenchment was in order. After Monsanto and Sharp, I suspect that the number of private dealer termination cases decreased

---

[33] Cf. Eastern Scientific Co. v. Wild Heerbrugg Instruments, Inc., 572 F.2d 883 (1st Cir. 1978) (price restriction for extra-territorial sales held to rule of reason standard, because price restriction would have no greater effect than air-tight territorial restraint).

[34] See R. Posner, "The Next Step in the Antitrust Treatment of Restricted Distribution: Per Se Legality," 48 U. Chi. L. Rev. 6, 10 (1981); Department of Justice, Vertical Restraints Guidelines § 2.3 (1985) ("bona fide distribution program embodying both nonprice and price restrictions [will be analyzed by the Department] under the rule of reason if the nonprice restraints are plausibly designed to create efficiencies and if the price restraint is merely ancillary to the nonprice restraints").

[35] D.H. Ginsburg, "Vertical Restraints: De Facto Legality Under the Rule of Reason," 60 Antitrust L.J. 67 & 68 (1991).

considerably, although I have no hard data to support this statement.[36]

The legal standards affected case generation in other ways, as well. After Sylvania and Monsanto, given the greater latitude for members of the business community to implement nonprice vertical restraints and the higher threshold required to prove an unlawful agreement on price, incentives to insist on resale price maintenance agreements would appear to be reduced. If a businessman or woman could protect his or her distribution system and price structure with lawful territorial and customer restrictions and careful dealer selection, why risk treble damage actions and a cease and desist order by using resale price agreements?

This does not mean, of course, that resale price maintenance has disappeared. As most of you know, the Commission in 1991 accepted consent agreements barring resale price maintenance in Nintendo of America, Inc.,[37] and Kreepy Krauly, U.S.A., Inc.[38] The complaint in Nintendo alleges that the company agreed with some of its dealers to maintain prices, and the order bars Nintendo from agreeing with dealers on the price at which its products are advertised or sold. As fencing-in relief, the order bars Nintendo for five years from terminating dealers because of the prices they charge for Nintendo products. The temporary suspension of Nintendo's right under Colgate to terminate discounters was thought to be justified to provide a buffer period in which to eliminate the continuing effects of the unlawful price maintenance agreements.

The complaint in Kreepy Krauly alleges that the company entered into written agreements with distributors fixing the resale prices for Kreepy Krauly automatic swimming pool cleaners,

---

[36] See Lovett v. General Motors Corp., 1993-1 Trade Cas. (CCH) ¶ 70,292 (8th Cir. 1993) ("[A]n inference of conspiracy [was] unreasonable in view of the strong competing inference that GM acted independently to preserve its distribution system."); see also Steuer, supra note 2, at 478 & 480 n.76 ("The law on dealer terminations has undergone intellectual convulsions in recent years.").

[37] Docket C-3350 (Nov. 14, 1991).

[38] Docket C-3354 (Dec. 20, 1991).

in the classic mode of Dr. Miles Medical Company,[39] although not on the same scale. The evidence of agreement was anything but ambiguous.

Both Nintendo and Kreepy Krauly are, in my view, traditional resale price maintenance cases, based on solid, unambiguous evidence of agreement. The Commission now has a number of ongoing investigations of possible resale price maintenance. One series of investigations involves manufacturers of consumer products that may be requiring their dealers to maintain resale prices. This investigation also raises the possibility of horizontal collusion. At least initially, the available documents and testimonial evidence appear to support the existence of resale price maintenance agreements. Another investigation involves documented threats to terminate discounters as a possible first step toward achieving agreement.

We want to be able to prove a violation, but other criteria also enter into the prosecutorial decision of whether to bring a case. If a seller's attempts to maintain prices are only episodic, ineffective or limited in other important ways, for example, there may be better uses for our resources.

Recently, the Commission also has brought cases against tying arrangements. In Sandoz Pharmaceutical Corporation,[40] the Commission challenged the tying of the drug clozapine to patient monitoring services. Clozapine is used in the treatment of schizophrenia, and for some patients, it appears to be the only effective treatment. Under federal law, Sandoz has exclusive rights to market clozapine until 1994. Patient monitoring services are essential for anyone taking clozapine, because of the possibility of potentially fatal side effects from the drug.

The Commission's complaint challenged Sandoz's requirement that clozapine purchasers buy patient monitoring services from Sandoz's designee, at a combined annual cost of about $9000. The arrangement would prevent others from providing monitoring services, although there was nothing unique about the monitoring services or the provider designated by Sandoz. As a result of the tie, patients using clozapine would be prevented from selecting alternative health monitoring services that might be more convenient or less costly. The order bars Sandoz from

---

[39] Dr. Miles Medical Co. v. Park & Sons Co., 220 U.S. 373, 409 (1911) ("The complainant having sold its product at prices satisfactory to itself, the public is entitled to whatever advantage may be derived from competition in the subsequent traffic.").

[40] Docket C-3385 (July 28, 1992).

requiring that patients buy the monitoring service designated by Sandoz, except as necessary to prevent inadequate monitoring.

In a second tying case, the Commission challenged the use of a tie to evade price regulation.[41] The case involved a doctor who owned both inpatient and outpatient kidney dialysis facilities and required those who wanted to use his outpatient facility also to use his inpatient facility. Patients had few alternatives to the doctor's outpatient facility, but his ability to raise prices was limited by Medicare regulations. By tying the outpatient facility to the unregulated inpatient facility, the respondent could raise the price above competitive levels. Kidney patients who needed both inpatient and outpatient services were prevented from selecting a different inpatient dialysis service. The order bars the respondent from tying the two services.

After a decade and more of adjusting to Sylvania and Monsanto, the recent decision of the Supreme Court in Kodak[42] has generated speculation that yet another era in antitrust is on the horizon. The decision in Kodak has been hailed by some as a repudiation of the primacy of economic theory in antitrust analysis following Sylvania in favor of a return to reality.[43] In Kodak, according to one commentator, the Court made clear "that defendants must do more than simply shout 'free rider' in a crowded courtroom in order to prevail on the merits."[44]

In Kodak, the Court said that it "preferred to resolve antitrust claims on a case-by-case basis, focusing on the 'particular facts disclosed by the record,'"[45] not theoretical arguments. The Court said that "actual market realities" and the

---

[41] Gerald S. Friedman, Docket C-3290 (June 18, 1990).

[42] Eastman Kodak Co. v. Image Technical Services, Inc., 112 S. Ct. 2072 (1992).

[43] E.g., W.B. Markovits, "A Focus on Reality in Antitrust: An Analysis of the Kodak Case," 39 Fed. B.J. 592 (Nov./Dec. 1992); S. Salop, "Kodak as Post-Chicago Law and Economics," Charles River Associates (April 1993).

[44] Salop, supra note 43, at 1. Former Antitrust Division Deputy Assistant Attorney General for Economics Janus Ordover responded that "simply shouting 'installed base opportunism' in a crowded court does not . . . justify a denial of a summary judgment." Antitrust 45 (Spring 1993).

[45] 112 S. Ct. at 2082 (citations omitted).

"economic reality of the market at issue should be examined."[46] In support, the Court cited Maple Flooring,[47] decided in 1925, and Sylvania,[48] so the principle is not new.

To hypothesize a change in approach at the Commission after Kodak, one would have to assume that we have been relying more on theory than on fact. I think that has not been the case. Antitrust analysis is fact-intensive, sometimes painfully so. The facts are fundamental in any enforcement decision. On the other hand, I assume that economic theory will continue to be important in antitrust analysis,[49] but perhaps the point to keep in mind is that theory is not all-important in the sense that it does not stand alone. Because almost anything can be true in theory, in making enforcement decisions, theory is only useful in combination with facts. Economic theory helps explain why things happen and can support new avenues for exploration of the facts. In vertical restraints cases, economic analysis applied to the facts can help provide alternative explanations for conduct and predict competitive effects. To the extent that Kodak may suggest a richer analysis, I think that the Federal Trade Commission has been ahead of its time.

A major theme of vertical restraints law in the past thirty years seems to be change. First Schwinn and then Sylvania reversed the direction of the law concerning nonprice vertical restraints, and Monsanto and Sharp changed the course for resale price maintenance and vertical agreements. With each new development in the law, the Commission has had to reassess where it has been and where it is going. This reassessment continues. In the meantime, it is important that the Commission maintain a credible enforcement presence in the area of vertical restraints. For the near future, I expect that the Commission will continue to devote resources to its vertical restraints program, and I hope that our cases will contribute to clarifying and structuring the analysis of vertical restraints under the law.

---

[46] Id.

[47] Maple Flooring Manufacturers Association, 268 U.S. 563, 579 (1925).

[48] 433 U.S. at 70 (White, J., concurring in judgment).

[49] See M. Klass & R. Rapp, "Litigating the Key Economic Issues Under Kodak," Antitrust 14 (Spring 1993) ("The frameworks of both [the Merger Guidelines and Kodak] are explicitly economic and both represent an increase in economic complexity from the past. . . . [U]nder the Guidelines, economists are kings. Under Kodak, if they are not sovereigns, economists might be, at the least, viziers.").